

NEW JERSEY DIVISION OF TAXATION TECHNICAL BULLETIN

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TAX: SALES AND USE TAX

TOPIC: SOFTWARE

Taxability of Tangible Software

Under the New Jersey Sales and Use Tax Act retail sales of tangible personal property are subject to tax except when a specific statutory exemption applies. There is no statutory exemption applicable to sales of software. Therefore retail sales of software contained in discs, CDs and in other tangible storage media are subject to tax.

The sale of a license to use software and the rental of software are treated the same as the sale of title to the software; they are all treated as “sales” for sales and use tax purposes. If it is pre-written software sold as is, or software modified for the customer, and if it is transferred to the retail customer in a tangible medium such as a CD or disc, then charges for the license, the rental, or the transfer of outright title to the software are subject to sales tax.

Software Sold in Tangible Form

Pre-written Software

Pre-written software is any software that is not designed and developed to meet the unique requirements of a specific purchaser and sold for that specific purchaser’s exclusive use. Pre-written software can be installed on the purchaser’s computer without significant modification. Pre-written software can also include software initially designed as “custom” software for a specific purchaser, which is subsequently sold as is to anyone other than the original purchaser. The retail sale of pre-written software is *taxable*.

Custom Software

In the current market, it is rare for a software designer to create software solely for one specific purchaser. Most software is instead already pre-written, and can be sold as is, or with some modifications to adapt it to the customer's special technical or business needs. In those exceptional circumstances when software is created, written and designed for the exclusive use of a specific customer, that customer's purchase of this entirely custom-made software is treated as a nontaxable professional service transaction, rather than as a purchase of the software itself. Even though the customer may receive the custom-made software in some tangible medium, the transfer of a disc or CD to the customer is deemed to be merely an incidental part of the sale of software development and design services, which remain *nontaxable*.

Modified Software

It has become commonplace for business customers to purchase pre-written software that has been modified somewhat to fit their technical or business requirements. When pre-written software is sold in some tangible medium, such as CD or disc, the transaction is a *taxable* sale of tangible personal property, regardless of whether the pre-written software is sold in its original form or with modifications to meet the purchaser's special need. However, the vendor of modified software has an option to charge a separate fee for the customization service. A separately stated, commercially reasonable charge for the professional service of modifying the software for the customer is nontaxable. If the vendor of modified software, sold in tangible form, instead chooses to charge a lump sum, without separately stating the fee for customization services, then the entire charge is subject to sales tax.

Software Sold in Intangible Form

When software is downloaded by the purchaser or transmitted to the purchaser electronically, the customer is deemed to be purchasing information in an intangible form. Unless the customer also receives a CD or disc or other tangible item in connection with the sale, the transaction is not deemed to be a purchase of tangible personal property and therefore is not subject to sales tax. If, however, a vendor delivers a CD or disc to the purchaser as a follow-up to the download, then the transaction is treated as the sale of tangible personal property and is taxable, unless the software was custom software designed for the exclusive use of that specific purchaser.

Installation and Maintenance Services and Service Contracts

Fees for the service of installing tangible software for the customer are subject to sales tax. They are treated as charges for the installation of tangible personal property.

Charges for the sale of a maintenance contract for tangible software are generally subject to tax. Software maintenance contracts usually include, among other things, the provision of updated, supplemental, and corrected software in tangible form. However, if a software maintenance contract covers only the provision of updates by electronic means, with absolutely no delivery of CDs, discs, or other tangible storage media to the customer, or only the provision of training, consultation, or of advice, help and customer support via telephone or online, then the charges are not taxable. A maintenance contract covering only custom-made updates of custom software, for the exclusive use of the original purchaser, would also be nontaxable.

Special Issues

“Load and Leave,” “Load and Mail,” and “Load, Copy and Mail”

Vendors sometimes send a service representative to a customer’s New Jersey location to install pre-written or modified software. In some circumstances, once the installation is complete, the tangible storage medium (CD, disc) is not left with the customer. This type of installation is referred to as “load and leave.” Pre-written or modified software transferred to the retail purchaser by means of load and leave is subject to tax. The transaction is deemed to be the sale of tangible personal property even though the tangible property does not remain permanently in the purchaser’s possession after the software content has been installed.

Some vendors instead send the CDs or discs to purchasers to load into their own computers. After the customers confirm that the software is working properly, they are obligated to return the CDs or discs to the vendor. This type of transaction is commonly called “load and mail,” and, like the “load and leave” transaction described above, it is subject to tax as the sale of tangible personal property, even though the customer does not retain possession of the tangible personal property.

Similarly, a “load, copy and mail” option results in sales tax liability for the purchaser of the software. In this option, the vendor sends the purchasers the CDs or discs to load into their computer, and also permits them to make tangible copies of the software on their own blank discs, before returning the originals to the vendor. Such “load, copy and mail” transactions are also subject to tax.

Electronically delivered software, supplemented by the transfer of tangible personal property

Software which is transferred to the purchaser by means of electronic telecommunication is treated as intangible property and is not subject to sales tax. However, if the purchaser also receives tangible property in connection with the sale (other than incidental property such as training manuals or warranty card), then the transaction is deemed to be a sale of tangible personal property and is subject to tax just as if the software were transferred to the purchaser solely through various tangible media such as CDs and discs. CDs, discs and other tangible storage media delivered to the purchaser are not treated as incidental, inconsequential elements of the transaction, and therefore they will cause the transaction to become subject to tax. If, however, software is transferred to the purchaser electronically and the vendor then sends a hard copy of the licensing agreement, warranty card, and training manuals, the transaction remains nontaxable, as a sale of intangible property, since the sale of the software was completed solely by electronic means, and the tangible property transferred was incidental and inconsequential to the true object of the transaction.